



Directorate of
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**International
Economic & Energy
Weekly**

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11 February 1983

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**International
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Synopsis

Perspective—Commodity Markets and LDC Debtors

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The fall in commodity prices since 1980 appears to be ending, but the consequences are far from over. Countries in the greatest financial difficulty will not necessarily be those that benefit first or most.

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Outlook for Commodity Prices

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The steep slide in nonfuel commodity prices that began in 1980—the most prolonged since World War II—appears to be over. In contrast to the price recovery following the 1974-75 recession, we expect this one to be neither strong nor rapid unless industrial country economic expansion develops much more momentum than most forecasters now anticipate. Even a robust recovery will not greatly help US producers who have lost markets to foreign competitors willing to sell below cost in order to earn foreign exchange.

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OPEC: Saudi Arabia on Center Stage

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OPEC's failure to agree on oil production quotas and price differentials and subsequent indications that Riyadh and other Arab countries on the Persian Gulf will soon cut prices have unleashed an outpouring of speculative pressure on the market. Although Riyadh would prefer that someone else take the lead, the Saudis may cut prices as early as next week by \$4 per barrel retroactive to 1 February 1983.

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World Steel: Another Bad Year

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Steel industries in the industrial countries have just been through their worst year since the steel crisis began in 1975. The coming year is likely to bring only moderate improvement, and the longer term outlook is not much better. In Western Europe, the continuation of heavy losses is threatening the EC's program to phase out subsidies and is likely to lead to new conflict within the community.

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USSR: Near-Term Grain Import Outlook

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With an estimated 1982 grain harvest of 165 million tons, we believe the USSR needs to import 42 million tons of grain to maintain current levels of meat production and satisfy other grain requirements in the current marketing year (July 1982-June 1983). The Soviets have already purchased over 30 million tons, but shipments during July-December were extremely slow. Moscow will have to import grain at a record pace over the next six months to reach 42 million tons. Any additional Soviet purchases of US grain above the 6 million tons already bought will probably be made within the next several weeks. If Moscow does not buy additional US grain, total imports are unlikely to exceed 37 million tons.

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El Salvador: A Beleaguered Economy

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El Salvador's GDP declined for the fourth straight year in 1982, leaving it 25 percent smaller than in 1978, the last year of relative political stability. Inadequate security and a severe foreign exchange shortage will prevent economic recovery this year. If the current level of insurgency continues, we estimate that about \$450 million in foreign assistance will be necessary to maintain GDP at last year's level.

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Perspective***Commodity Markets and LDC Debtors***

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The fall in commodity prices since 1980 appears to be ending, but the consequences are far from over. While the OECD recession, now three years old, greatly reduced demand for Third World commodities, LDCs maintained production in order to protect export earnings and employment. As a consequence, many markets were flooded, causing prices and export revenues to plummet. Since 1980 agricultural commodity prices have fallen by one-third and those for industrial materials by nearly as much.

It may be months before economic recovery in the West gathers enough steam to increase demand for LDC commodities appreciably. For one thing, rising protectionist pressures in the OECD countries are likely to hold down demand for some LDC products. Moreover, even if a strong recovery occurs, as it did following the 1974-75 recession, it probably would take at least six months before prices of industrial materials begin a sustained rise.

Apart from uncertainties about the strength of an economic upturn, we believe other factors may delay or weaken a recovery in commodity prices:

- There are large surpluses of most agricultural commodities, and increases in cultivated land and improvements in agricultural technology promise to expand output regardless of demand.
- Large stockpiles and slack capacity overhang most metal markets. Outside the Communist world, unused capacity and stocks as a percent of consumption in 1982 represented 22 and 28 percent, respectively, for aluminum; 26 and 17 percent, respectively, for copper; and 40 and 68 percent, respectively, for tin.
- The LDCs, which greatly increased their own consumption of metals in the 1970s, will be financially unable to undertake large metal-intensive capital projects in the foreseeable future.
- Inflationary expectations, which helped boost commodity prices during the last recovery, have been dampened.

In any event, economic recovery will affect LDCs with different timing and intensity. Countries in the greatest financial difficulty will not necessarily be those that benefit first or most.

- *Argentina* and *Brazil* depend heavily on agricultural exports, which are not particularly sensitive to the business cycle. Their exports of manufactures will benefit sooner if they have enough supplier credits to take advantage of an upturn in demand.

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- *Mexico* and *Venezuela* depend on oil for almost all of their export earnings. Their financial position will not improve as long as oil prices remain weak.
- *Chile, Peru, Zambia, and Zaire* on the other hand, rely on metals for most of their export earnings and should be among the countries that benefit most from recovery in the industrial countries. The impact, however, may not be felt for several months.

The countries in the best position to take advantage of OECD economic recovery are the East Asian exporters of consumer manufactures. Demand for these goods typically is the first to revive when an upturn occurs. Thus the chief gainers—South Korea, Hong Kong, Taiwan, and Singapore—will be the countries whose financial problems are the least worrisome.

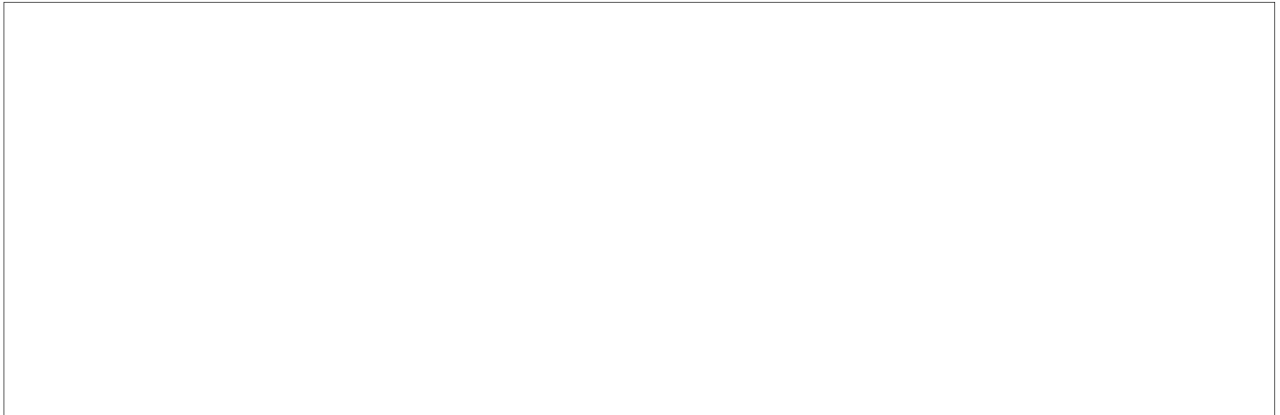


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Briefs**Energy***Kuwait Buys
Gulf Oil Assets
in Western Europe*

After lengthy negotiations, Kuwait announced last week that it would purchase Gulf Oil's refining and distribution operations in Belgium, the Netherlands, and Luxembourg. The deal includes a 75,000-b/d refinery in Rotterdam and about 750 service stations throughout the three countries. While the price was not announced, it is estimated to be about \$500 million. Embassy reporting indicates that the initial payment to Gulf Oil would be 6 million barrels of crude oil, reportedly priced at about \$27 to \$28 per barrel. According to Kuwait's Oil Minister the purchase represents the first step in a number of "downstream" investments in Western Europe, with talks continuing on possible Kuwaiti acquisition of Gulf Oil assets in Scandinavia and Italy.

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*Kuwait Initiates
Gas Project*

Kuwait recently awarded a contract to the French company Technip for construction of an offshore gas-gathering system for the Khafji and Hout oilfields in the Kuwait-Saudi Arabia Neutral Zone. Technip's successful bid of \$150 million reportedly was about \$60 million under the next lowest. The system will take an estimated two and a half years to construct and, when completed in 1986, will provide an estimated 2 million cubic meters per day of associated gas. While this represents only about 15 percent of Kuwait's average daily gas production in 1982, it will further reduce flaring and provide additional flexibility for Kuwait, whose domestic gas system has recently been hampered with shortages caused by low levels of crude oil production.

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Gasification Project
Canceled***

Gasunie, the Dutch gas monopoly, has dropped plans for the construction of a 1-billion-cubic-meter-per-year coal gasification plant in Eemshaven. Declining demand for gas, sharply rising investment costs, and uncertain prospects for oil and gas prices have undermined the project's viability, according to Gasunie officials. Gasunie had planned to blend low-BTU coal synthesis gas with high-BTU gas from the Groningen field. The project was one of the largest in Western Europe and was intended to prolong the life of domestic Dutch gas reserves. [REDACTED]

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***Denmark To Restrict
Purchases of
South African Coal***

In late January the Danish parliament passed an anti-apartheid resolution aimed at gradually eliminating purchases of South African steam coal by 1990. Danish electric utilities currently import about 3 million tons of South African coal. Because South African coal is usually priced about \$7 to \$12 per ton below coal from other countries, the US Embassy estimates that restricting such purchases could cost Denmark about \$45 million in 1990 alone. The loss of South African coal could benefit US coal exporters, who currently account for one-third of Danish coal imports. [REDACTED]

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International Trade, Technology, and Finance***Venezuelan Financial
Situation Deteriorates***

Difficulties in refinancing maturing loans, continued high levels of capital flight, and the prospects of further cuts in oil prices point to increasing financial strains for Venezuela in the next few months. Refinancing efforts are being hampered by recurrent arrears on some small government-guaranteed loans. Moreover, we estimate that capital flight from Venezuela has escalated to as high as \$35-40 million per day. Nongold reserves now stand at about \$8.0 billion, about half the yearend 1981 level. International bankers, concerned with the continued decline in reserves and the prospect that further disarray in OPEC will result in lower oil earnings, undoubtedly will shy away from extending large new credits to Venezuela and hamper efforts to roll over old debts. [REDACTED]

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As a result, Caracas will face an intense liquidity squeeze in the next 60 days. The Embassy estimates that by 31 March Caracas will need to cover \$3.5 billion of maturing short-term debt and \$450 million in principal payments falling due in this period. Capital flight will add to foreign exchange requirements by further draining liquid reserves. Finance Minister Sosa already is attempting to work out a program with international lenders for over \$9.0 billion in financing. Serious negotiations, however, probably will be held up until the cabinet can decide how best to stem foreign exchange losses. Meanwhile, Caracas will rely on stop-gap measures such as urging exchange banks to limit the sale of dollars. [REDACTED]

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Despite these moves, it is unlikely that Venezuela will be able to come up with \$4 billion by the end of next month. Finance Minister Sosa has suggested that Caracas will resort to a partial suspension of principal payments this year and will soon request formal debt rescheduling. The Venezuelan Government—especially President Herrera and Central Bank President Diaz Bruzual—would like to postpone any drastic economic policy moves such as a needed devaluation or more formal exchange controls until after the elections in late 1983. Foreign creditors, on the other hand, are likely to demand an approach to the IMF, with attendant exchange rate adjustments and tighter austerity measures, before rescheduling can take place. [REDACTED]

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*US-EC Agricultural
Trade Dispute
Escalates*

At the EC Agricultural Council meeting early this week, member countries criticized the US sale of subsidized wheat flour to Egypt last month. While France did not call for breaking off scheduled talks with the United States, it did question their usefulness. A prepared French statement circulated at the meeting called the US move an act of commercial war and suggested the Community take “appropriate” measures to dissuade the United States from further actions aimed at the EC. EC Agricultural Commissioner Dalsager described the US sale as being outside the spirit of the series of high-level US-EC talks and referred to the US wheat flour sale as the first step of a trade war. The EC plans to ask for GATT consultations with the United States on the subsidy issue. [REDACTED]

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Pressures are rising in member countries for the EC to take a harder line toward the United States on agricultural trade disputes. The French are the most bitter over the US flour sale, in part because France is the largest EC producer of wheat. West German opposition to US agricultural policies, however, could soon intensify if the United States concludes negotiations with Egypt for the sale of dairy products. West Germany, along with France, is the Community’s largest dairy producer and contributes substantially to the financing of EC dairy surpluses. Should the EC choose to retaliate, it probably would restrict US access to the lucrative EC market rather than risk a costly subsidy war over third-country markets.

*Gaps in Mexico’s
Foreign Financing*

Mexico is requesting \$500 million in emergency financing from commercial banks to cover shortfalls caused by delays in the disbursement of a \$5 billion loan package being arranged. Initial disbursements, which were to be made in mid-January, probably will not be released until next month. As a result, Mexico is again critically low on foreign reserves and missed the payment on 31 January of past-due private-sector interest. The US Embassy reports that bankers are unreceptive to the request for the emergency loan and that Mexico City may ask for further assistance from the United States. [REDACTED]

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Unless Mexico can arrange the bridge loan, it will fall behind on public-sector interest payments, and past-due private-sector debt payments—now over \$2 billion—will continue to mount. Even with the credit, the government will be able to service public-sector interest payments for only about three weeks. Mexico City is unlikely to cut essential imports—now 50 percent below the level of last year—to meet debt service obligations. [REDACTED]

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*Obstacles to
Brazilian Financing
Plan*

Since late December Brasilia has gained nearly total support for two phases of its financing program—securing new money and refinancing maturing loans—but it is encountering difficulty in rebuilding the short-term credit position included in the program's four-part package. [REDACTED]

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West German banks probably will resist Brazil's short-term financing requests most strongly because they doubt the program will work. If the Brazilians do not gain their support by 1 March, they will lose the commitments already made by other banks to the financing program. New short-term credits are necessary to avert cash problems until Brazil can draw on new bank credits and deposits. If this package comes apart, Brasilia will have to suspend payments to foreign creditors and reschedule its debts. [REDACTED]

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*Sudanese Official
Debt Rescheduled*

The Paris Club's rescheduling of Sudan's official debt last week relieves a major problem for the financially strapped Nimeiri regime and sets the stage for efforts to reschedule debts to Arab states and private creditors. The lenders rescheduled arrears and payments for 1983 totaling \$500 million. The terms provided are generous—a 16-year repayment schedule with a six-year grace period when only interest is paid. Furthermore, during the grace period Sudan will pay only 50 percent of the interest due with the remainder to be added to the rescheduled debt. As a result, Sudan's payments to Paris Club creditors in 1983 will be only \$20 million, all that Sudan can handle according to recent IMF estimates. Sudan will now seek rescheduling of \$1 billion in arrears and payments for 1983 owed Arab oil-producing states and \$1.2 billion due commercial creditors. [REDACTED]

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*Costa Rican
Debt Problems*

Costa Rica faces problems that could set back negotiations on the rescheduling of its \$1.1 billion foreign commercial debt. Repayments on government-to-government debt already have been rescheduled through yearend 1983. A Swiss investor is suing Costa Rica for alleged default on an international bond issue. San Jose has not paid interest on bonds since November 1981 when a steering committee of creditor banks insisted that bonds be included in the

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commercial debt restructuring. Should the Swiss investor win his case, Costa Rica will either pay and thereby incur the wrath of the other creditors waiting in line or be declared in default, triggering cross-default clauses on the rest of its commercial debt. International bankers are waiting to see if the case sets a precedent in determining whether bonds can be excluded from debt reschedulings in other countries. [redacted]

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National Developments

Developed Countries

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French Borrowing Plans

The French Government is seeking \$3 billion in commercial bank loans to support the franc and to cover the current account deficit. [redacted]

[redacted] Paris recently has been running a monthly trade deficit of \$1-1.5 billion, and support of the franc last month alone cost the Treasury an estimated \$4 billion. [redacted]

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The use of nationalized companies as surrogates for national borrowing—a common practice since the mid-1970s—is intended in this instance to avoid domestic criticism about the size of additional loans Paris is likely to seek. Large foreign borrowings have become a political issue, and the Socialist government does not want to give domestic critics new grounds for charges that its policies are bankrupting the Treasury. The government will need funds, however, if it has to continue to support the franc—another political issue for the opposition—until the municipal elections in March. The timing for the loans will depend on interest rates and the strength of the franc. [redacted]

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Possible IMF Assistance for Greece

Greek officials apparently have met with IMF representatives to discuss Greece's deepening balance-of-payments difficulties—foreign exchange reserves late last year fell to the equivalent of three weeks of imports. An IMF technical team, which visited Athens in early December, reportedly advised Greek officials to seek commercial loans before appealing to the Fund for help. At the same time, the team recommended that the Fund prepare to loan Athens \$1 billion over three years if the Greek Government would agree to a package of austerity measures. Prime Minister Papandreu probably is not yet prepared to incur the domestic political costs of turning to the IMF. His leftwing constituents already are irate about what they believe are austere government policies and would balk at measures they deemed still more restrictive. [redacted]

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Since the IMF team made its recommendations, Athens has announced a restrictive incomes policy for public employees, devalued the drachma by 15 percent, and imposed import restraints. There is no evidence that the government has taken these steps at IMF direction. Given indications that the commercial credit market is growing increasingly wary about lending to Athens, however, it seems likely that Greek officials made their decisions with an eye to keeping the IMF option open. [redacted]

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*Australian Wheat
Production Plummets*

[redacted] the 1982/83 wheat harvest is virtually complete and totals 7.7 million tons—some 1.3 million tons below Canberra's estimate and a dramatic drop from last year's total of 16.4 million tons. Rainfall in the primary wheat-growing areas was 70 percent below normal last year, and US Government experts see little immediate relief in sight. Concern now is that continued dry conditions will not only severely hamper this season's coarse grain crop (primarily corn and sorghum) and next season's wheat crop, but will also further limit water supplies available for residential consumption and industrial uses. [redacted]

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Less Developed Countries

*New Israeli
Cost-of-Living
Adjustment*

The new cost-of-living formula, agreed to last month by labor, industry, and government officials, is only a slight change from the old formula. Because it leaves intact the system of additional wage negotiations at the industry and plant levels, the new formula probably will have little impact on real wages or triple-digit inflation. Quarterly cost-of-living adjustments will now be 80 to 90 percent of the increase in the consumer price index during the previous three months. The old system granted wage hikes of 80 to 90 percent of the average CPI increase in the previous quarter relative to the quarter before that. Finance Minister Aridor argues that the new formula will result in wage adjustments that will better reflect current price rises, particularly during periods of decelerating inflation. As long as the Histadrut, the large labor organization, can negotiate additional wage gains at the industry and plant levels, however, labor will be in a position to bargain for additional wages to compensate for inflation. Real wages have increased at an average annual rate of 7 percent since 1975, a major cause of accelerating inflation during the period. [redacted]

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*Mexican Labor Group
Demands Emergency
Wage Hike*

Labor leaders have requested a meeting of the national minimum wage commission to consider an emergency wage increase. Fidel Velasquez, head of the largest government-affiliated labor organization, claims that a 29-percent increase in consumer prices last month has wiped out the 25-percent minimum wage settlement of 1 January. In a related development, the government has announced a program to ensure that prices of 17 basic foods do not increase faster than wages. [redacted]

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A substantial wage hike now would disrupt the IMF program and probably cause Mexico to miss several first-quarter economic performance targets by wide margins. Velasquez's inflation estimate probably is too high, but the rapid price increases that have already occurred are likely to prompt labor leaders to demand higher subsidies and a price freeze on additional basic consumer goods. Prospects for demonstrations against austerity policies by the labor rank and file and by opposition parties are growing. [redacted]

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*Bolivian Debt to
US Oil Companies*

The Siles administration is continuing efforts to settle a \$59 million debt to two US petroleum firms operating in Bolivia for their share of the oil produced. Prospects for meeting this summer's settlement deadline, however, are bleak. La Paz was counting on revenues from natural gas sales to Argentina this year, but Buenos Aires already is over \$90 million behind on payments. In early December, the US Embassy in La Paz assisted in a barter arrangement involving 800,000 barrels of petroleum as an initial payment on the oil debt, but the actual transaction has not yet occurred. Bolivia's only other move to date was a "good faith" payment in late December of \$1.3 million on its arrearages. [redacted]

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*Indonesian Oil
Revenues Declining*

Indonesian officials are increasing efforts to obtain foreign loans to compensate for declining oil revenues. The head of the Central Bank says Jakarta will need considerably more this year than the \$1.25 billion it borrowed abroad in 1982, hinting the figure could exceed \$2 billion. Indonesia is arranging a \$1 billion commercial credit from foreign banks, the second largest ever granted to an Asian borrower. According to the US Embassy, Jakarta also is trying to obtain new loans from Middle Eastern banks. [redacted]

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The Indonesians have become especially concerned about their financial position as a result of OPEC's recent failure to agree on prices and production quotas. Production in Indonesia has fallen to 1.1 million b/d, 200,000 below the OPEC quota and 500,000 below capacity. Indonesia now appears willing to accept loans tied to the US prime rate, which is higher than the rates it demanded only a few months ago. Jakarta also appears anxious to arrange new loans quickly, because it fears credit terms for less developed countries will become tighter later this year. [redacted]

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*Guinea Delays
Iron Ore Project*

[redacted] Guinea's plans of becoming a leading exporter of iron ore have been shelved because of weak market conditions. Some of the shareholders in the \$1 billion project—which include US Steel, several foreign governments, and Guinea—reportedly want to wait until international prices rise at least 60 percent. A final decision is likely at a shareholder meeting this month. Guinea's President, Sekou Toure, views the

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project as the key to reviving Guinea's economy. Moreover, the need for Western technical and financial assistance figured prominently in Toure's decision in the mid-1970s to move closer to the West. An indefinite delay in the project may prompt Toure to reassess the usefulness of such ties. []

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*Moroccan Phosphate
Earnings Languish*

Morocco's depressed phosphate industry is not likely to improve this year. Phosphate rock sales—which accounted for 41 percent of export earnings in 1982—are unlikely to increase from the reduced level of 16.5 million tons shipped last year. Rabat also may be forced to cut rock prices by as much as \$5 per ton to preserve its market share. [] Such a cut would reduce export earnings by about \$100 million, an amount approximately equal to potential savings that would be earned from a \$4-per-barrel drop in the nation's oil imports. In addition, below average rainfall in recent months raises the prospect of another poor grain harvest, thus increasing the negative impact of a drop in phosphate earnings. []

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*India Decries US Stand
on ADB Loan Request*

US opposition to Indian borrowing from the Asian Development Bank has angered Prime Minister Gandhi and, according to the Embassy in New Delhi, will have a negative impact on overall bilateral relations. New Delhi, which has not previously borrowed from the ADB, is seeking approximately \$2 billion in nonconcessional project loans for 1983-87. Indian officials have long been aware that the United States does not favor Indian borrowing, but the dispute has intensified during the past few months when active negotiations about a general capital increase for the ADB have become tangled with negotiations about the Indian loan request. India's balance-of-payments prospects have deteriorated since early 1981, when New Delhi first sought access to ADB funds. Gandhi's closest advisers believe that the United States has been actively campaigning against Indian borrowing and are skeptical of assurances to the contrary. []

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*Pakistan Buoyed by
US Vote on
IMF Support*

The IMF Executive Board last week voted in favor of the third and final disbursement of Pakistan's \$1.7 billion three-year Extended Fund Facility (EFF) loan arrangement, with the United States casting a positive vote. Despite the balance-of-payments assistance from the IMF, Pakistan still is negotiating to reschedule loan payments falling due this year. Pakistan probably will seek to obtain additional IMF and World Bank support after the EFF expires in November. []

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*Communist**Stagnation in Soviet
Standard of Living*

Statistics just released by the Central Statistical Administration indicate that the standard of living in the USSR last year stagnated at best. According to the official report on the performance of the Soviet economy in 1982:

- "Real per capita income"—actually a constant-price measure of total consumption minus some services—rose by only 0.1 percent.
- Retail sales in constant prices increased by only 0.3 percent, implying a per capita decline of about 0.6 percent. Retail trade accounts for about three-fourths of Soviet personal consumption.

The virtual flattening of these two key Soviet measures of well-being is unprecedented. In 1981, real per capita income rose by 3.7 percent and in 1976-80 at an annual average rate of 3.2 percent. The corresponding figures for per capita retail sales were 2.6 percent and 3.7 percent, respectively. Our calculations also show little growth in real per capita consumption last year—a 0.4-percent rise, down from an increase of 1.2 percent in 1981. [REDACTED]

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Since domestic production of most consumer goods and services rose in 1982, though more slowly than in 1981, it is not clear why consumption as reported by the Soviets leveled off. Net imports of consumer goods may have been cut back or inventories may have been increased. A major diversion of consumption from state stores and collective farm markets to semilegal and illegal outlets could also have been a factor. [REDACTED]

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*Chinese Grain
Purchases From
Argentina*

[redacted] China has purchased over 1 million tons of Argentine wheat since December. Traders believe the two countries may have increased the amounts called for in their long-term grain agreement originally scheduled to run from 1981 through 1984. Since 1981 the Chinese have purchased only small quantities of Argentine grain because the Soviets have taken most of the available supplies. [redacted]

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Although Beijing recently threatened to reduce purchases of US grain in retaliation for US-imposed textile restrictions, the Chinese appear to be buying Argentine wheat for economic reasons. The Argentines, who have had a record harvest and are offering low prices, could have supplied the Chinese with more grain, particularly in light of Soviet inactivity in the Argentine market. Relatively high prices probably will keep China out of the US grain market over the next few months, and purchases later in the year may depend on how the textile issue is resolved. [redacted]

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*Further Expansion of
Chinese-Italian
Nuclear Cooperation*

[redacted] China and Italy late last year signed a two-year agreement that significantly expands technical cooperation in nuclear science and technology. The new accord will provide training for Chinese personnel in fusion research, fuel cycle technology, thermal reactor development, and fast reactor technology. China's decision to increase its cooperation with Italy is consistent with Beijing's policy of diversifying sources of foreign technology. Since 1978 China has turned increasingly to Western Europe for scientific data and technology to support its modernization program and recently signed a nuclear-related cooperation agreement with France. We believe the agreements are designed, in part, to provide China with equipment and technology that cannot be obtained from US sources. [redacted]

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For the Italians, the agreement will help promote commercial sales in the nuclear field. Since 1981 Beijing has purchased nuclear technology from an Italian firm, which is planning to help the Chinese design and build a facility for nuclear fuel reprocessing. This plan has only been partially implemented, however, because of Italian concern for protecting proprietary information associated with the sale. Italy, moreover, is bound by COCOM controls and would have to obtain permission to sell reprocessing technology. [redacted]

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Outlook for Commodity Prices

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The steep slide in nonfuel commodity prices that began in 1980—the most severe and prolonged since World War II—appears to be over. In recent months, most broadly based indexes of mineral and agricultural commodities have leveled off or inched upward in expectation of economic recovery in developed countries. In contrast to the price recovery following the 1974-75 recession, we expect this one to be neither strong nor rapid unless industrial country economic expansion develops much more momentum than most forecasters now anticipate. In any event, commodity prices normally lag at least six months behind a turnaround in economic activity. Even a robust recovery will not greatly help US producers who have lost markets to foreign competitors willing to sell below cost in order to earn foreign exchange.

Commodity Price Trends

Plagued by oversupply and weak demand, commodity prices continued to slide in 1982, although at a slower rate. *The Economist* price index of industrial materials, composed of 20 metals and materials, fell nearly 15 percent in 1982, while a similar index for food commodities was down about 20 percent. By yearend, average commodity prices were roughly 35 percent below their 1980 peak.

Metals

Although metal producers in the developed West sharply reduced output in 1982, demand fell even more as industrial production slumped. In most cases, yearend 1982 inventories were above yearend 1981 levels:

- **Copper.** Copper prices fell 15 percent in 1982 as a result of weak demand—particularly in construc-

tion and transport equipment—and mounting inventories, which reached a four-year high. US copper producers were hard hit. In late 1982 the industry was operating at a rate 15-20 percent below 1981. In contrast, LDC producers, many of which are government controlled and account for an important share of their country's employment, typically continued to pour out metal. Indeed, in 1982 Chilean output was a record 1.2 million tons as the government sought to maintain export earnings.

- **Aluminum.** Aluminum prices on the London Metal Exchange averaged 45 cents per pound in 1982, off 22 percent from the 1981 average. Production in the United States fell to a 14-year low. These and other cuts—Japan's output was down 54 percent—brought consumption and production into near balance but did nothing to alleviate the large overhang of metal on world markets. Inventories stood at a record 3.2 million tons as of September 1982.
- **Lead.** Lead lost one-fourth of its value in 1982 as demand fell to its lowest level since 1975. A weak automotive sector was the primary culprit.
- **Tin.** Despite massive stockpile purchases by the International Tin Council, tin prices fell by 9 percent in 1982. Non-Communist demand registered its lowest level in more than two decades, and inventories grew to the equivalent of eight months of consumption. Although production has been trimmed somewhat, mainly by Malaysia and Thailand, output through October continued to exceed demand by some 10 percent.

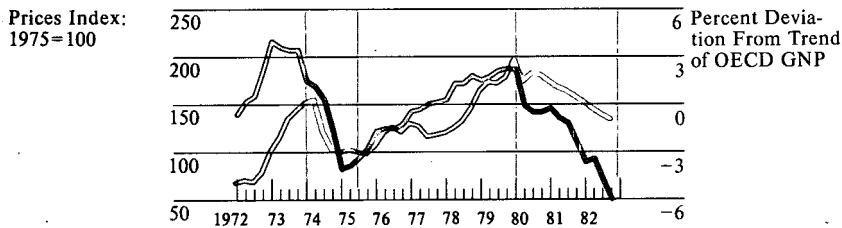
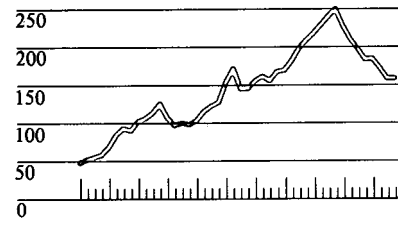
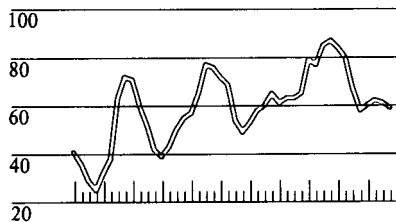
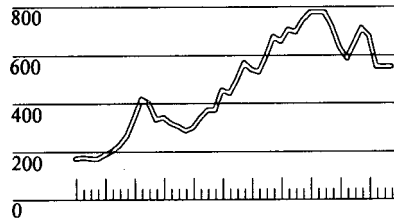
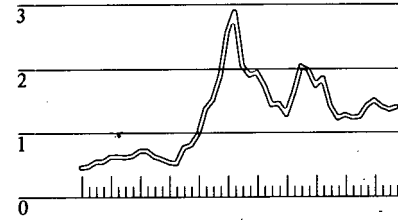
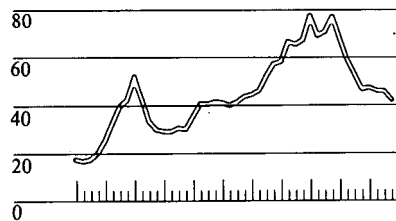
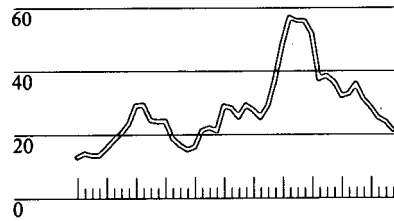
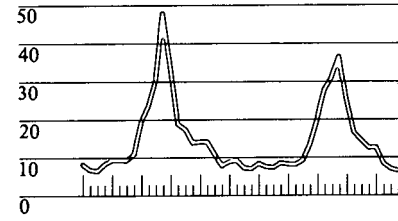
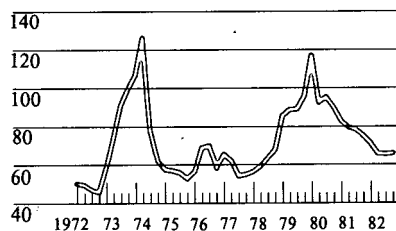
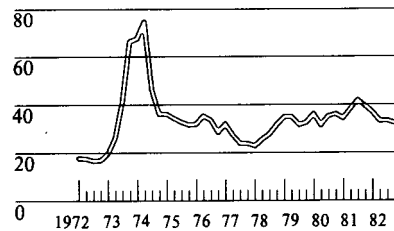
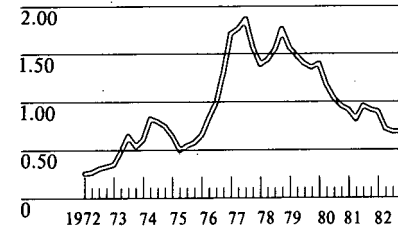
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Commodity Prices^a

Note change in scales

Industrial Materials Prices and OECD Business Cycle^bFood Index
Index: 1975=100Cotton
US ¢ per PoundTin
US ¢ per PoundCoffee
US \$ per PoundNatural Rubber
US ¢ per PoundLead
US ¢ per PoundSugar
US ¢ per PoundCopper
US ¢ per PoundZinc
US ¢ per PoundCocoa
US \$ per Pound^a Quarterly averages.^b Shaded areas indicate periods of recession.

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World Metal Stocks

Thousand tons

	1974	1975	1976	1977	1978	1979	1980	1981	1982
Lead									
Stocks	524	577	472	468	394	458	525	518	582 ^a
Consumption days	59	64	45	41	34	39	48	48	56
Zinc									
Stocks	727	1,136	1,141	1,195	833	868	787	875	776 ^b
Consumption days	58	115	99	101	64	66	63	71	67
Copper									
Stocks	1,049	1,744	1,828	1,961	1,535	1,090	1,029	1,087	1,221 ^c
Consumption days	58	115	102	103	75	52	52	54	63
Aluminum									
Stocks	2,012	3,128	2,321	2,505	2,052	1,513	2,078	3,115	3,180 ^d
Consumption days	64	130	75	79	61	43	62	100	101
Tin									
Stocks ^e	39	43	38	32	27	27	33	45	111
Consumption days	70	89	70	63	53	53	67	99	250

^a Through November.^b Through August.^c Through July.^d Through September.^e Includes ITC buffer stocks.

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Since late December *The Journal of Commerce* index of metal prices has rebounded 18 percent. According to industry sources the price surge has been fed by speculators hoping to cash in on a metal market recovery. This move, however, seems premature. We believe this because stock overhangs and new orders for final products indicate that most metal markets will remain weak until demand picks up appreciably, possibly later this year. As a result, we do not believe the recent high rate of increase in metal prices will be sustained unless an unexpectedly sharp economic recovery occurs.

We anticipate the recovery in commodity prices will be quite different from the one that followed the 1974-75 recession. At that time, metal prices rode the Western recovery to record highs; by 1980

they had doubled. This time, however, most observers expect that growth in the OECD economies, at least for 1983, will be only about half the rate that followed the last recession. More important, industry sources believe that investment in new plant and equipment—the bellwether of metal demand—will grow little if at all because about one-third of OECD industrial capacity sits idle, long-term interest rates remain high, and industry profits have fallen sharply. Some of the unused capacity in basic, metal-intensive industries may never be reactivated as the structure of output in the OECD countries continues to change.

Furthermore, during the last economic recovery prices were forced upward by speculators who

Secret**World Agricultural Stocks***Million tons*

	1974	1975	1976	1977	1978	1979	1980	1981	1982 ^a
Grain									
Stocks	134.5	122.6	122.1	177.0	170.0	191.9	171.4	154.6	196.1
Percent of consumption	12.9	12.3	12.2	16.6	15.5	16.4	14.5	13.1	16.7
Oilseeds									
Stocks	11.1	12.7	15.0	10.6	12.0	13.7	24.5	19.8	19.1
Percent of consumption	9.2	10.7	11.8	8.5	8.6	9.3	15.5	12.5	11.4
Cotton									
Stocks	6.9	5.6	6.7	5.2	4.4	5.4	4.8	4.8	4.9
Percent of consumption	54.3	41.5	50.0	39.4	33.6	39.4	33.8	33.6	34.3
Coffee									
Stocks	2.2	2.7	2.4	1.5	1.8	1.5	1.6	1.9	2.7
Percent of consumption	45.8	60.0	51.1	33.3	43.9	30.0	32.6	39.6	52.9
Sugar									
Stocks	17.3	18.9	20.9	24.8	29.8	30.6	23.6	25.0	35.4
Percent of consumption	21.6	24.5	26.5	31.3	34.6	34.2	26.4	28.1	39.5

^a Preliminary.

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bought nonprecious metals as a hedge against depreciating currencies and by metal users who built up inventories to protect against price increases. Sharply lower inflationary expectations are not likely to provide a boost to metals prices such as occurred in the late 1970s.

Demand for metals will be constrained even more by the weakened financial position of the LDCs. Many of these countries had been involved in building up infrastructure through the construction of large metal-intensive capital projects, and they accounted for a growing share of world metal use during the 1970s. For example, between 1970 and 1980 LDC copper consumption doubled, as did its share of non-Communist use. Slower economic growth and severe debt problems will tend to limit LDC investment in metal-intensive industries, certainly during the next 18 to 24 months.

On the supply side, strike-induced disruptions are not likely, even though major lead, zinc, and copper

contracts in the United States will be up for renegotiation by midyear. Given the weak state of the metal markets, the long period of high unemployment among miners, and the poor financial position of many metal companies, labor in producing countries may try to avoid strikes. If wages and benefits remain stable, as industry representatives expect, it will minimize cost-push effects on metal prices.

Agricultural Products

Good harvests, huge carryovers, and depressed demand put downward pressure on farm commodity prices in 1982:

- **Sugar.** Last year's world sugar crop was the largest in history, but consumption increased less

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than 1 percent. In the United States, which accounts for 9 percent of world usage, consumption fell about 6 percent. Slow or negative income growth in the LDCs and strong competition from corn-based sweeteners also restrained sugar demand. As a result, world stocks reached almost 40 percent of consumption, and world sugar prices plummeted 50 percent to the lowest level in 10 years.

- **Grain.** World grain markets in 1982 were characterized by sluggish demand, depressed prices, and mammoth additions to stocks. Last year's record US corn crop will help boost world grain stocks to a record 196 million tons, about 17 percent of annual consumption. During the last two years world demand fell by 14 million tons while production increased by almost 50 million tons. Prices have dropped to a three-year low. Fierce market competition among major grain exporters has resulted, increasingly involving attractive finance packages and concessionary repayment terms.
- **Cotton.** Cotton prices fell 16 percent last year, reflecting continued weak textile demand. Although stocks are larger than producers would like, they compare favorably to levels in the mid-1970s, which were one-third greater.
- **Oilseed.** World oilseed production reached a record high in 1982 with large increases in soybean output from the United States, Brazil, and Argentina. Prices fell 16 percent as surpluses mounted.
- **Cocoa.** Large-scale plantings when prices were high led to five years of surplus production and depressed prices last year to 35 percent of their 1977 peak. The International Cocoa Organization, which does not include the Ivory Coast—the world's largest producer—has been unable to boost prices to planned levels through market intervention. The impact of declining prices has been particularly severe for Ghana, the world's third-ranking producer, which depends on cocoa

for at least 60 percent of its export earnings. Last year, Ghana's cocoa revenues were only about half the 1979 level.

Although agricultural prices have leveled off in the past few weeks, they have not rebounded as have metal prices. Indeed, the outlook for agricultural commodity prices remains bleak for at least the next year and probably longer. Factors such as past investments in better farming technology, land development, and marketing infrastructure will continue to swell world farm production despite low prices. New land continues to be brought into production, and most of the world's prime farmland is being worked more intensively. Efforts by governments to protect their farm economies through domestic price supports and import quotas, to maximize food export earnings, and to conserve foreign-exchange spending on food imports encourage even greater farm surpluses.

- Not even the vagaries of weather, which contributed to a fourth consecutive poor grain harvest for the USSR and cut Australia's 1982 grain crop in half, have stemmed the tide; world grain output will set a record this year.
- The coffee industry faces huge stocks as a result of expanded plantings following the Brazilian freeze of 1975.
- Cocoa prices are likely to remain well below the levels of the late 1970s because of expanding production from plantings already in place. The International Cocoa Organization estimates that prices will fall in real terms through 1985.

Meat consumption has plateaued in countries such as Japan and even the United States as a result of stagnating real incomes, rising trade barriers, and dietary shifts. Price declines at the production level have provided little stimulus to consumer demand because much of the savings has been absorbed by rising costs in processing and distribution. High oil prices and low commodity prices have dealt the

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non-OPEC LDCs a double blow, greatly limiting their buying power. With rapidly growing populations, however, the LDCs remain the most likely source of long-term growth in demand for farm products.

Implications for the United States

Weak prices for agricultural commodities, particularly grain and soybeans, will continue to have a negative impact on the US balance of payments. USDA reports that agricultural exports in fiscal 1982 were down 11 percent from the record of \$43.8 billion in fiscal 1981, and it expects a further decline this year.

Low farm product prices are also intensifying protectionist agricultural policies. The EC's Common Agricultural Policy is largely responsible for shifting the Community from a major net grain importer, buying as much as 20 million tons a year on the world market, to a significant wheat exporter. The EC is now the world's fourth-largest wheat exporter, second-largest beef exporter, the world's largest poultry supplier, and the world's largest exporter of sugar to the free market. In 1980 the EC also accounted for some 60 percent of world exports of butter and nonfat dry milk. The loss of traditional export markets to the EC has goaded other farm product exporters into action:

- More than a dozen nations have filed formal protests against the EC's Common Agricultural Policy.
- The United States has authorized the first buyer incentives for farm exports since the early 1970s.
- Canada is financing grain sales at below-market interest rates.
- The United States has threatened to dump its huge dairy surplus on world markets if the EC enacts import taxes aimed at US soybean meal and corn gluten feed.

Japan's protectionist policies also are under attack. Import quotas and high internal prices have kept Japanese meat consumption well below levels of other industrialized countries, restraining demand for feedgrains as well.

The long slump in commodity prices may well represent a watershed for the US metal industry. During the 1970s the industry experienced rapidly rising costs caused by the sharp rise in energy prices and the crescendo of concern over environmental protection. It did not recover from the recession of 1974-75 until late in the decade. Now US nonferrous mines and smelters as well as iron ore mines and steel mills have closed or gone on reduced hours. Since 1980 employment has declined 8 percent in the lead industry, 15 percent in aluminum, about 30 percent in steel and copper, 35 percent in zinc, and over 50 percent in iron ore—perhaps as many as 200,000 workers in total. Even with permanent closings, capacity utilization at yearend 1982 was down to 65 percent in the aluminum, copper, and lead industries, 50 percent in zinc, 30 percent in steel, and only 10 percent in iron ore.

The competitive pressures from LDC mineral producers will remain strong, in part because they continue to push output and exports in an effort to maintain foreign exchange earnings and service their debts. Some LDCs have even accepted barter arrangements in order to unload surplus supplies. In recent weeks both General Motors and Chrysler, for example, have concluded agreements with Jamaica to trade vehicles for Jamaican alumina.



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OPEC: Saudi Arabia on Center Stage [REDACTED]

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OPEC's failure to agree on oil production quotas and price differentials and subsequent indications that Riyadh and other Arab countries on the Persian Gulf will soon cut prices have unleashed an outpouring of speculative pressure on the market. The unloading of inventories and falling consumption forced OPEC production down sharply in January to about 17.4 million b/d. Output is running even lower in February, as buyers continue to watch for the first break in prices. Reluctance of others, principally North Sea producers, to cut prices puts the burden of price reduction on the Saudis. Although Riyadh would prefer that someone else take the lead, [REDACTED]

[REDACTED] the Saudis may cut prices as early as next week by \$4 per barrel retroactive to 1 February 1983. While we believe that a Saudi price cut would force most OPEC nations to cooperate, we think a period of competitive price cutting might well precede an agreement to uphold the new benchmark. [REDACTED]

Saudi Strategy and Objectives

In a departure from past strategy, Saudi Arabia is aggressively trying to force OPEC members to accept pricing and production agreements to Riyadh's liking. We believe that Saudi policy is coordinated closely with other OPEC members of the Gulf Cooperation Council (GCC)—Kuwait, the UAE, and Qatar—and that the individual pricing and production policies of these states are part of a larger, Saudi-sponsored strategy. The Saudis and Arab Gulf states need to stop the steady erosion of their market shares and attendant loss of revenues that has taken place over the past 18 months. [REDACTED]

Riyadh has generally preferred to take a passive course to attain its objectives, varying oil output to

OPEC Crude Oil Production

Million b/d

	1982		1983
	4th Qtr	December	January ^a
Total	19.3	19.0	17.4
Algeria	0.7	0.7	0.7
Ecuador	0.2	0.2	0.2
Gabon	0.2	0.2	0.2
Indonesia	1.3	1.3	1.2
Iran	2.9	3.0	3.0
Iraq	0.8	0.8	0.8
Kuwait	0.7	0.6	0.6
Libya	1.7	1.7	1.4
Neutral Zone	0.4	0.4	0.3
Nigeria	1.4	1.2	0.8
Qatar	0.3	0.3	0.3
Saudi Arabia	5.4	5.1	4.7
UAE	1.3	1.3	1.1
Venezuela	2.2	2.3	2.1

^a Preliminary.

[REDACTED] stabilize supplies and prices throughout 1982. Riyadh did not foresee the dramatic market turnaround caused by the 1979-80 price runup, nor the deep and persistent recession. The impact of conservation and fuel substitution, compounded by the drawdown in oil company stocks, was also greatly underestimated. These factors caused OPEC crude oil production to drop by over 8 million b/d—or 30 percent—in two years, while OPEC's share of Free World output fell roughly 10 percentage points to less than 50 percent in 1982. The Saudi share of OPEC production fell from 42 percent in 1981 to 34 percent last year. [REDACTED]

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Saudi hopes that demand would uphold the \$34 benchmark price were based on expectations that economic recovery would begin in the West and that the general drawdown in inventories would end. Neither has materialized, and the Saudis face the prospect of having to absorb further losses in sales unless prices are realigned. As it is, Saudi production is probably running well below the 4.7 million b/d reported for January. In the short term Riyadh wants a pricing structure that shifts more of the burden of declining oil demand on other producers. For the long term Riyadh evidently wants to implement a pricing pattern that would enable the Saudis to maintain a strong influence over the world oil market. [REDACTED]

Warnings to OPEC "price-cheaters" have thus far had no effect. Most non-GCC members of OPEC are ignoring previous production agreements, in many cases producing close to capacity until very recently. Reporting from several sources indicates that the Saudis, along with their GCC partners, now want oil prices to drop by about \$4. The Saudis' problem is to engineer the price cut in such a way as to restore the competitive price differentials for Gulf crudes. If possible, Gulf producers would prefer not to initiate the drop, hoping instead that North Sea producers will make the first move and force Nigeria into being the first OPEC member to "break the ice." But we believe that the GCC members are prepared to act if prices hold much longer. [REDACTED]

The Iranian Problem

Iran, largely to finance its war effort, has become the most flagrant violator of OPEC pricing and production agreements. Faced with a serious foreign exchange bind, Tehran began aggressive price cutting to expand its oil market share in early 1982. With discounts as much as \$6 below the OPEC benchmark price production climbed quickly, and is now averaging about 3 million b/d. [REDACTED]

Besides improving its own revenue position dramatically, Tehran has been able to deny Iraq badly

needed hard currency. For one thing, it has captured most of the market share lost by the Saudis and other Gulf producers—Iraq's main benefactors. At the same time, Tehran has conspired with Syria to close the Iraq-Syria oil export pipeline and to sell Iranian oil to Syria. [REDACTED]

Saudi-Iranian rivalry and mutual dislike is a factor in the current war of nerves within OPEC. We cannot determine, however, to what extent political motivations are influencing Tehran's pricing and production actions. At a minimum we believe that political considerations are reinforcing financial interests that, in our view, are the most important factors driving Iran. Political considerations—which country will be the dominant force in the Persian Gulf—are also playing an important role in the Saudi determination to push the price issue. To avoid direct confrontation with Tehran on the oil market issue, the Saudis are willing to let the UAE and Kuwait take the lead in making public demands for better OPEC discipline. [REDACTED]

Iranian oil policy in the near term will be formulated largely in response to Saudi initiatives. Tehran would undoubtedly match an initial \$4 price cut. Revenues would still be more than adequate to support the war effort and maintain current levels of government spending. A price cut of more than \$4 per barrel, however, would begin to cause increasing financial strains. Moreover, Tehran already is producing near capacity; it cannot market significant amounts of new crude to raise additional revenues. Without this ability, Iran's response to a price cut probably does not weigh heavily in the Saudi position. [REDACTED]

Saudi Options

The Saudis and other GCC members appear to have three basic options to try to bring prices down and regain some control of the market. In order of increasing risk to the Saudis, they are:

- A passive approach of letting some other major producer take the initiative in cutting prices. Saudi cuts would follow the lead of others.

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- Initiating a price cut of \$2 to \$4, either publicly as a joint GCC decision, or unofficially through price discounts. This might be followed by another attempt to forge an effective OPEC agreement on pricing and production.
- A large preemptive price cut, probably accompanied by increased production to flood the market with cheap oil. The Saudis and GCC members, with their large financial reserves, could outlast other OPEC members who would either have to make their peace with Saudi Arabia or see their market share taken away by cheaper Gulf oil.

The increasing risks the Saudis must consider include financial dislocation in the world economy, major strains in OPEC—including possible disintegration—and heightened hostility from Iran in particular, including the possibility of military retaliation.

We believe the Saudis are about to give up on the first option. The United Kingdom and Mexico—major non-OPEC exporters—are both reluctant to initiate price cuts that provoke retaliatory cuts by OPEC countries. Mexican and British prices already are below those for comparable OPEC crudes.

The Saudis now appear to have settled on the second option and are considering ways to make it succeed. GCC members have been issuing a steady stream of threats to cut prices and to expand output if other OPEC producers pursue present policies. According to reporting from Kuwait, the GCC has informed other OPEC members that agreement on a \$30 benchmark with acceptable production quotas and price differentials must be reached before mid-February. Failing this, the GCC would meet again to announce a unilateral price cut of \$4 per barrel. Also, Yamani met last week with the major US buyers of Saudi crude, reportedly to tell them that Riyadh would cut prices by \$4 a barrel in February and make the cut retroactive to the first of the month.

At this time Riyadh appears to prefer a publicly announced price cut rather than privately discounting its oil sales. There are indications that some discounts have been offered to Petromin customers to forestall further production declines, but these offers have apparently not been extended to the former Aramco partners.

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A major preemptive cut of \$10 per barrel or more appears to be ruled out for the moment, although the option could be revived. We believe the Saudis would be willing to risk this option to force OPEC to come to terms. The Saudis are mindful of the risks involved, but are aware that they and other GCC members can tolerate an all-out price war longer and easier than anyone else in OPEC. In addition, most of those cheating on prices—particularly Nigeria and Venezuela—could not stand a price war for long because of their financial problems. Even the knowledge that the GCC states were serious in their threats to pursue this option might be enough to make these countries amenable to adopting meaningful pricing and production guidelines. Concern over military reprisal from Iran in response to such an action could weigh heavily against this option.

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In the end Riyadh could, as in the past, opt to do nothing. Although this is at odds with activist Saudi initiatives of the past month, important decisions never come easily to Riyadh. A further postponement of the cut is possible.

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Problems Ahead

Speculative pressure on oil prices could intensify following a price drop if buyers expect further cuts. Unilateral price cuts would feed such expectations. Despite company efforts to reduce inventories over the past year, excess stocks still exist because consumption has been lower than expected—especially during fourth quarter 1982. The ability of Saudi Arabia and its GCC partners to convince buyers that \$30 per barrel is an appropriate benchmark would hinge on OPEC's ability to effectively

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limit production. If Saudi Arabia lost control and a downward price spiral occurred there is a good chance that it would be short lived as incentives for producers to submit to discipline would grow rapidly. Also, once buyers believe that oil prices have bottomed out, speculative pressures will probably reverse. [redacted]

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A price cut by the Saudis could spark a period of competitive price reductions as other OPEC members attempt to maintain revenue levels by expanding their market share. The most likely to respond are Nigeria, Venezuela, and Indonesia since they have unused capacity and need the money. Libya also has excess capacity but is in better financial shape. Even without Iranian acceptance of an agreement, we believe other producers eventually will be sufficiently cooperative after a Saudi price cut to assist in defending a new benchmark. [redacted]

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World Steel: Another Bad Year

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Steel industries in the developed countries have just been through their worst year since the steel crisis began in 1975. Although financial losses in the EC probably were no worse than in 1981, the US industry suffered its biggest loss since the Great Depression. Profits in the Japanese steel industry dropped sharply and by the end of the year had virtually disappeared.

Western steel production occurred chiefly in the EC where slumping economic activity, higher imports, and reduced exports caused production to fall about 12 percent. Third World countries managed to achieve a small production increase last year, primarily because of higher output in South Korea and Taiwan.

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The coming year is likely to bring only moderate improvement, and the longer term outlook is not much better. The struggle for sales in a smaller market is leading to resurgent protectionism in many countries. In Western Europe, the continuation of heavy losses is threatening the EC's program to phase out subsidies and is likely to lead to new conflict within the Community.

Financial Position Worsens

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Financially, 1982 was a disaster for most of the major steel producers. Preliminary reports issued by some of the major European companies indicate losses in the EC about equal to the \$4 billion deficit of 1981. In the United States, company reports available so far point to a \$2.5-3.0 billion loss on steel operations. If nonrecurring items were added—such as the writeoff and closing costs for mills shut down—US losses would approximate \$4 billion. Among the major countries, only the Japanese industry managed to stay in the black, partly because of the aftermath of the 1981 boom in oilfield tubular goods. By yearend, however, even the Japanese industry reported that it was operating close to its break-even point.

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Declining Output

In 1982 steel production in non-Communist countries fell to less than 400 million tons, nearly 14 percent below 1981. Lower production in the developed countries accounted for all of the decline, with output falling considerably below the recession level of 1975. At the beginning of 1982, output in the developed countries was running at a seasonally adjusted annual rate of about 380 million tons. By the end of the year, the rate was down to 295 million tons.

Although output fell in all the major countries, the United States accounted for two-thirds of the total decline with production sinking to the lowest level since 1946. While much of the drop in US output was due to the depressed demand in metal-using industries, shipments also fell sharply as consumers used up their steel inventories in order to keep new orders at a minimum. The rest of the decline in

Losses were caused in part by lower operating rates. For the year as a whole, US steel mills used less than half their capacity, compared with 78 percent the year before. By yearend, capacity utilization had fallen to 30 percent. The EC employed only 55 percent of its steel plant during the year with operating rates declining below 50 percent toward the end of the year. In Japan operating rates changed little from 1981.

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Losses also piled up as steel prices were unable to keep up with rising material and labor costs. Only

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World Steel Production*Million tons*

	1974	1975	1976	1977	1978	1979	1980	1981	1982 ^a	1983 ^b
Total	709	645	677	676	717	748	717	708	644	660
Non-Communist countries	492	420	450	441	465	494	462	455	392	406
Developed countries	461	387	412	397	417	438	404	395	330	343
United States	132	106	116	114	124	123	102	109	66	87
European Community	156	126	135	127	134	141	129	126	111	105
Japan	117	102	107	102	102	112	111	102	100	97
Other ^c	56	53	54	54	57	62	62	58	54	54
LDCs	31	33	38	44	48	56	58	60	62	63
Communist countries	217	225	226	235	252	253	256	253	252	254

^a Preliminary.^b Projected.^c Including other European countries, Canada, South Africa, Australia, and New Zealand.

in the EC domestic market were prices appreciably higher in 1982; the EC Commission and the larger steel companies managed to enforce an average increase of about 15 percent for the year as a whole. Even in the EC, pressure from rising excess capacity and growing import competition finally cracked the industry's discipline, and prices declined during the second half of the year.

Steel industry wage and material costs continued to rise slowly in 1982. For the Japanese and the Europeans, local currency costs for imported raw materials and fuels were increased somewhat by dollar appreciation during the year. Lower operating rates also caused some deterioration in plant efficiency, raising operating costs per ton.

Wage rates increased in most countries despite rising unemployment among steel workers. Employment in the EC steel industry declined by about 30,000 workers during 1982 adding to the 250,000 steel workers laid off since 1974. The situation was even worse in the United States with steel industry employment averaging about 100,000 jobs below that of 1981.

Foreign Trade and the Rise of Protectionism

Steel export volume held up fairly well during 1982 because exporters continued to force steel into a weakening market. Japanese exports remained at the 1981 level, while lower EC exports were offset by somewhat higher export activity by the Third World. Because export volume remained relatively high, weakening demand forced export prices downward. Spot prices for cold rolled sheet from Europe, for example, fell from about \$390 per ton in early 1982 to around \$315 at yearend.

As competition became more intense, a rash of protectionist actions hit the world's steel trade. Besides US countervailing duty and antidumping actions against the EC, Canada took steps to halt alleged dumping of steel by a number of countries, including several EC members. Elsewhere Turkey and Australia imposed higher duties on imported steel during the year. Toward the end of the year,

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Spain was considering antidumping actions against some EC steels, and Japan was looking at possible dumping charges against steel imports from several Third World countries. In Latin America, the major producing countries were considering a scheme to promote trade in steel within the region through preferential tariff arrangements and a "buy Latin America" campaign. [REDACTED]

Actions taken or under consideration by the EC include:

- Antidumping actions against Spain, Brazil, and Venezuela.
- The adoption of accelerated antidumping investigation procedures.
- Increased minimum prices for imported steel.
- The negotiation of lower import quotas in its bilateral steel trade agreements with 13 major steel suppliers. [REDACTED]

Pessimistic Outlook

EC and Japanese producers opened the year with operating rates well below their depressed 1982 levels, and this situation is expected to continue at least through the first half of the year. Unless recovery is very sharp, their production for the full year will again decline. Although the outlook in the United States is clouded by the possibility of a strike in late summer, a partial recovery in output is forecast by most industry observers; steel inventories are at rock bottom and the end to stock liquidation should produce some increase in orders. [REDACTED]

Financially, the outlook is mixed for the major steel producers. The US industry should cut its losses sharply as production increases. Most analysts expect that operating rates will remain below the break-even point, however. The profit situation in Japan apparently is still deteriorating as operating rates fall. The industry has announced a reduction in its investment spending and one of the largest steel companies has stated that it will cut executive salaries. [REDACTED]

There are indications that the EC situation may grow worse in 1983. German steel officials are forecasting that their industry could lose about \$1 billion this year, probably more than the losses of 1982. Korf-Stahl has just gone into receivership and Saarlöhle is on the verge of it. Together these two companies represent about one-tenth of the West German industry. A commission appointed by the companies to study Germany's steel problems has now recommended a sweeping reorganization of the industry involving mergers among the leading firms. [REDACTED]

The failure of EC steel producers to improve their financial performance will be particularly significant in 1983 because the Community is scheduled to begin withdrawing its steel subsidies this year. According to the agreement reached in 1981, the EC Commission will accept no new request for emergency aid beyond the end of 1982. Aid will continue to flow under old authorizations and for capital investment and other purposes. As time goes on, however, conflict is likely to develop between the industry's continuing need for financial assistance to cover heavy losses and the EC's intent to gradually bring aid to an end. The likely breakdown of the plan to terminate the steel subsidies probably will create further problems within the Community. [REDACTED]

The steel industry's long-term prospect remains grim. During its annual meeting in Tokyo last October, the International Iron and Steel Institute (IISI) forecast that steel consumption in non-Communist countries would reach about 525 million tons in 1990. Since current steelmaking capacity is estimated by the industry at about 670 million tons, the IISI forecast suggests that the industry will suffer the burden of excess capacity and depressed prices for some time to come. Moreover, trade problems are likely to continue as countries attempt to maintain employment and higher operating rates by pushing exports. [REDACTED]

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USSR: Near-Term Grain Import Outlook

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With an estimated 1982 grain harvest of 165 million tons, we believe the USSR needs to import 42 million tons of grain to maintain current levels of meat production and satisfy other grain requirements in the current marketing year (July 1982–June 1983). The Soviets have already purchased over 30 million tons, but shipments during July–December were extremely slow. Moscow will have to import grain at a record pace over the next six months to reach 42 million tons. Any additional Soviet purchases of US grain above the 6 million tons already bought will probably be made within the next several weeks. If Moscow does not buy additional US grain, total imports are unlikely to exceed 37 million tons.

Soviet Import Needs

Last fall we predicted that Soviet grain imports in the 1983 marketing year would reach a record 50 million tons. When the Soviets bought grain at an unexpectedly slow pace during first-quarter MY 1983, we reexamined their 1982 grain harvest, their policy toward increasing meat availability, and their ability to pay for grain imports. Based on larger forage and potato crops in 1982 and an apparent decision to forgo, at least for the present, any improvement in consumer diets, we have reduced our estimate of Soviet grain import needs for MY 1983 to 42 million tons. This estimate, in turn, could be off by several million tons given the uncertainties associated with the underlying data. To reach the 42-million-ton level, however, Moscow will have to step up grain shipments sharply between now and June.

USSR: Grain Imports

Million tons

	1981/82 ^a Imports	1982/83	
		Purchases to Date	Shipped During Jul-Dec ^b
Total	45.0	30-32	13.0
United States	15.4	6.0	1.9
Canada	9.2	10.7	5.5
Argentina	13.2	7-9	2.0
European Community	2.7	3.3	1.5
Australia	2.5	1.0	0.2
Eastern Europe	1.5	1.5	1.5
Other	0.5	0.7	0.4

^a 1 July–30 June.

^b Estimated.

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Soviet Activity Through December

The Soviets have already purchased 30-32 million tons of grain for delivery by 30 June 1983.¹ Grain shipments are lagging badly, however. During July–December, shipments totaled only about 13 million tons—8 million tons below the level of the comparable period last year. Most of the reduction has been at the expense of the United States and Argentina whose first-half shipments to the USSR

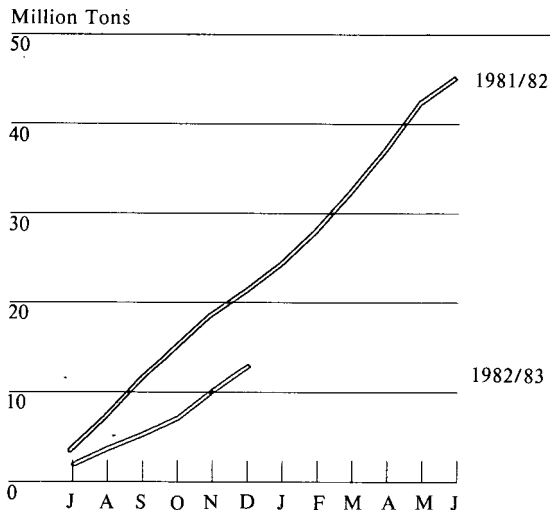
¹ USDA estimates the current level of commitments at 26-27 million tons. Our estimate includes transactions—almost entirely sales by Argentina and Canada—that have been reported by trade sources but that have not been officially reported by the respective countries.

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USSR: Cumulative Grain Shipments

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were each off by more than 60 percent from last year's levels. The Kremlin may have reasoned that with its greatest need for grain imports coming in the spring, small purchases and shipments during the summer and fall would conserve hard currency and not increase world prices.

Outlook for January-June

For imports to reach 42 million tons, Moscow will have to take delivery of 29 million tons during January-June. Monthly shipments, in turn, would need to average 4.8 million tons, 20 percent higher than last year's average for the same six-month period and much higher than the average level for the first half of this marketing year. The USSR should be able to absorb this amount. In April of 1982 Soviet ports handled 5 million tons of grain. If new facilities under construction at Novorossiysk on the Black Sea are completed by the end of

March, grain-discharge capacity could reach an estimated 5.4 million tons per month. Soviet grain-handling capability will probably drop by some 10 percent in early June, however, when railcars will be diverted to transport domestic grain from the 1983 harvest.

Moscow's financial position is not expected to pose a problem for Soviet grain buyers over the next six months. many US bankers have overcome their reluctance to lend to the Soviets and have joined West European and Canadian bankers in providing short-term financing for Soviet grain purchases. These credits coupled with a substantial improvement in the Soviet foreign exchange situation during first-half 1982 should enable Moscow to pay for as much grain as Soviet ports and railroads can handle.

The Soviet Union will have little difficulty finding grain in a world market that is struggling with sluggish demand, depressed prices, and mammoth additions to already record stocks. Exportable supplies of wheat and coarse grains from the major US competitors are expected to increase slightly over last year's record level. Seasonal factors, however, limit Soviet freedom in selecting grain suppliers through March. Specifically, non-US suppliers can ship only 6.5-7 million tons during the first calendar quarter.

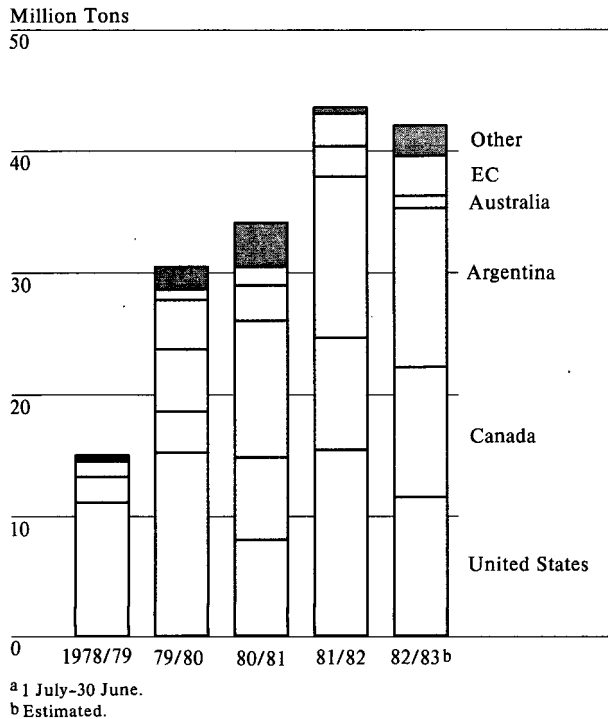
Canada. Moscow has already purchased 10.7 million tons of Canadian grain, roughly half of which was shipped during the first six months of MY 1983. Delivery of the remaining 5.2 million tons will be limited by the freezing of the St. Lawrence Seaway. When the Great Lakes reopen in April, the Soviets will have about 3.7 million tons to ship during April-June. This compares with Canadian shipments of 3.3 million tons over the same period last year.

Argentina. Soviet purchases from Argentina so far have reached 7-9 million tons. Shipments during July-December of only 2 million tons, however, are

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USSR: Grain Imports^a



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down sharply in comparison with the 6.5 million tons shipped during the same period in 1981. During January-June we expect Moscow to take delivery of about 4 million tons of wheat purchased from this year's huge Argentine crop. In addition, we anticipate sizable coarse grain shipments for the period, boosting total Soviet imports for the year to 13 million tons. This depends, however, on Argentina having a good coarse grain harvest that will enter export channels in April and on Moscow's willingness to buy.

European Community. The USSR has bought 3.3 million tons of the EC's 8 million tons of wheat available for export. About 1.5 million tons were delivered during July-December and roughly half

of the remaining 1.8 million tons is scheduled to be shipped by the end of March. We anticipate no additional EC sales because varieties available do not match Soviet needs. (C NF)

Other Suppliers. Australia will be able to send only about 1 million tons to the USSR during the winter because of this year's drought-reduced harvest. In addition, we expect Eastern Europe, Thailand, Spain, Brazil, and Austria to supply about 3 million tons to the Soviets in MY 1983. About 2 million tons from these various suppliers, including Australia, were shipped during July-December, leaving 2 million tons for shipment during January-June.

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Role of the United States

Soviet purchases of US grain currently stand at 6 million tons—the minimum specified in the US-USSR grain agreement. Two million tons of grain were shipped from US ports by the end of December, and Moscow has scheduled delivery of most of the remaining 4 million tons during January-March. Any major additional purchases of US grain are likely to be made within the next several weeks because of the combination of seasonal grain shortages in non-US exporting countries and the Soviet need to prevent shipping bottlenecks in April-June.

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Purchases by the USSR of US grain may be guided more by politics than by economic requirements. Although Soviet grain buyers have maintained daily contact with US traders, the Soviets have made clear their intentions to minimize purchases from the United States. If Moscow's purchases from the United States are limited to the 6 million tons, total imports for the marketing year are unlikely to exceed 37 million tons. To the extent that Moscow forgoes additional US grain, it will have to make internal adjustments—assuming that we have accurately estimated the need for grain and the grain crop size. The USSR could ease the

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shortfall in the near term by reducing the quantity of grain used for food and industrial purposes, saving perhaps up to 5 million tons of grain. They could also cut livestock herds, thereby increasing meat supplies temporarily, but reducing meat over the next year or two. Feed supplies could be stretched even more than at present by reducing livestock rations. While this would save several million tons of grain, it would result in lighter slaughter weights and reduced milk yields. [REDACTED]

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Looking Ahead

If a bumper harvest results this year, imports could be greatly reduced from the levels of the past few years. If grain production does not pick up this year, however, Moscow will face the difficult decision of whether to cut the long-established goals for meat production or to boost grain imports, thus heightening its dependence on the West for its grain needs. Given present grain production trends, we expect Moscow to have few problems meeting the lion's share of its future grain import needs from non-US suppliers. [REDACTED]

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El Salvador: A Beleaguered Economy

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El Salvador's GDP declined for the fourth straight year in 1982, leaving it 25 percent smaller than in 1978, the last year of relative political stability. Hope for improvement, sparked by the March 1982 rejection of the insurgents at the polls, was quickly snuffed out by a resurgence of guerrilla violence and a deepening world recession. The Magana government has been unable to restore critical private-sector confidence or stem capital flight.

Inadequate security and a severe foreign exchange shortage will prevent economic recovery this year. If the current level of insurgency continues, we estimate that about \$450 million in foreign assistance will be necessary to maintain GDP at last year's level. Even with this amount of financial support, a deterioration in security could precipitate a sharp drop in national output and aggravate already high unemployment.

The Unraveling of the Economy

Beginning in 1979, El Salvador's economy was battered by a series of internal and external shocks. The most destructive was the escalation of civil violence into full-fledged insurgency. Antigovernment guerrillas sabotaged electric power and industrial plants, interdicted communications and transportation networks, and disrupted the agricultural sector. Sagging business confidence led to the closure of many businesses and factories, a sharp decline in private investment, and massive capital flight. By 1981 the insurgents had acknowledged economic deterioration to be a key ingredient in their strategy to destabilize the government.

In the spring of 1980 a new military junta introduced a series of far-reaching reforms that compounded the country's economic difficulties. The

package of reforms—including comprehensive land redistribution, nationalization of banks, and establishment of government monopolies for marketing coffee and sugar—was intended to defuse leftist violence and to promote economic diversification. Because the land reform in particular was poorly planned and not adequately supported by government technical and credit assistance, the reforms set back production of El Salvador's cash crops. Uncertainty regarding future ownership of unredistributed land resulted in considerable decapitalization and abandonment of farm operations.

Meanwhile, external developments added to the economy's woes. El Salvador suffered a sharp deterioration in its terms of trade with the near tripling of the price of imported oil during 1979-81 and the precipitous drop in the price of coffee, the commodity that consistently had accounted for more than one-half of the country's export earnings. Its previously fast-growing industrial exports to neighboring Central American countries also fell off. Declining export earnings coupled with the continuing net outflow of private capital prompted San Salvador to draw its international reserves down heavily to cover its import needs; by yearend 1981 net reserves were \$240 million in the red.

To shore up the country's crumbling economy, San Salvador instituted a National Emergency Plan under which it hiked wage rates, expanded public construction, and boosted defense spending. Because of growing inflation and balance-of-payments deficits, the government was forced in 1981 to shift to greater austerity measures, such as trade and exchange controls and a freeze on wages and some prices. Still, because of a sharp drop in coffee revenues, public-sector deficits continued to climb from 2.4 percent of GDP in 1979 to 8.6 percent in 1981.

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El Salvador: Balance of Payments*Million US \$*

	1977	1978	1979	1980	1981	1982 ^a
Current account balance	31	-286	35	18	-287	-270
Trade balance	43	-227	105	100	-188	-185
Exports (f.o.b.)	974	802	1,130	1,072	793	735
Coffee	606	386	675	615	452	398
Cotton	76	98	85	83	53	50
Sugar	26	19	27	13	14	13
Shrimp	10	11	12	13	19	24
Other	256	288	331	348	255	250
Imports (c.i.f.)	931	1,029	1,025	972	981	920
Net services and transfers	-12	-59	-70	-82	-99	-85
Capital account	14	323	-142	-350	149	311
Official transfers (net)	-14	127	91	144	229	350
Private transfers (net)	28	196	-233	-494	-80	-39
Errors and omissions	0	-1	6	7	6	0
Change in net reserves	45	38	-101	-284	-107	20
Arrears on international payments				41	25	-21

^a Estimated.

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Dashed Hopes in 1982

Early last year, a small economic turnaround seemed possible. Widespread expectations for the start of world economic recovery, higher coffee prices, and large increases in IMF and US financial assistance—including the largest allocation under the Caribbean Basin Initiative—seemed to provide grounds for optimism. More important, the insurgents appeared to have been dealt significant military and political setbacks when better than 80 percent of eligible voters went to the polls in March to vote in a constituent assembly election in which the extreme left refused to participate. The massive turnout was motivated largely by a popular backlash against guerrilla attacks on their economic livelihood.

Visions of better economic times soon faded. An unexpected deepening of world and regional reces-

sions devastated Salvadoran export earnings. Stagnant foreign demand and sizable world stocks kept the price of coffee low; cotton and sugar prices continued to plummet. In addition, US sugar quotas and the International Coffee Agreement imposed constraints on volumes that El Salvador could sell abroad. The government was unable to attract private foreign financing. US and IMF financing increased but not as much as San Salvador had anticipated. As a result, foreign exchange constraints forced the government to cut back real imports 12-14 percent by yearend 1982.

Domestic events also tended to work against economic recovery. After the March election, efforts to form a new national unity government disintegrated into bickering among political and military leaders, thereby diverting attention from the war

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and enabling the guerrillas to regroup, rearm, and map new strategies. In the second half of the year, the insurgents resumed their military initiatives inflicting major damage to productive capacity and disrupting economic activity.

At the same time, political infighting and inconsistent signals regarding government commitment to the reforms engendered considerable uncertainty about policy continuity. Attempts by the extreme right to tamper with the agrarian reform, though nullified by moderate elements led by independent President Magana and Defense Minister Garcia, foreshadowed a period of intense political maneuvering between the two factions.

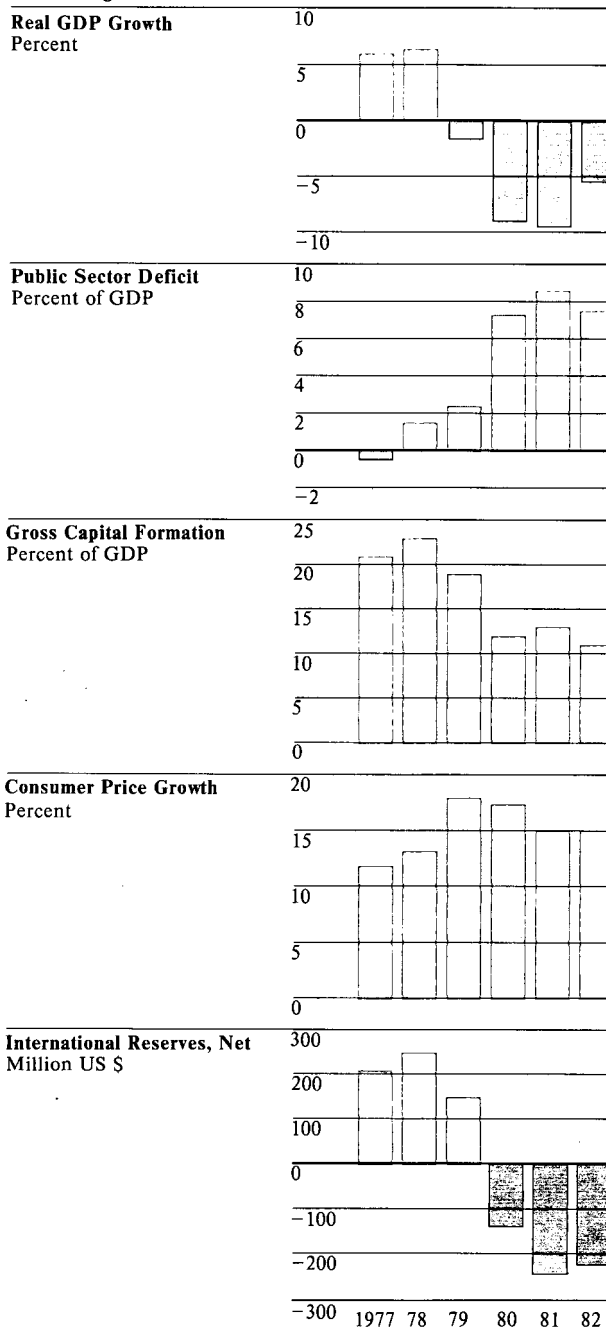
San Salvador also had to tighten its austerity program over the course of the year. To qualify for a one-year \$85 million IMF loan agreement in July, the government was obliged to pare public-sector deficits and borrowing, raise interest rates, slow credit expansion, and make the exchange rate system more flexible. Based on early USAID estimates, we believe that public-sector investment was slashed by more than one-third in real terms to meet IMF-mandated targets. This—and reduced bank credit expansion—apparently created domestic currency shortages for both the private and public sectors.

We believe that, together, the renewed guerrilla attacks, scarce foreign exchange, and government austerity caused a 5- to 6-percent real contraction in El Salvador's GDP last year. Total public and private gross capital formation was an estimated 11 to 12 percent of national output, roughly one-half of the 1978 share. A rise in business bankruptcies, reduced agricultural production, and growing numbers of persons displaced by the insurgency swelled the ranks of the unemployed to more than 30 percent, according to the US Embassy.

All major sectors contributed to last year's economic decline. Agricultural output, which accounts for one-fourth of GDP and more than one-half of the country's employment, fell substantially. Coffee production was hobbled by a combination of inadequate maintenance of plantations because of future

El Salvador: Economic Indicators

Note change in scales



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El Salvador: Crop Production*Index: 1978=100*

	1979	1980	1981	1982 ^a
Export crops				
Coffee	110	109	97	92
Cotton	82	79	56	49
Sugarcane	87	69	61	75
Basic crops				
Corn	103	103	98	81
Beans	107	90	88	88
Rice	115	120	82	73

^a Estimated.

land ownership uncertainties, spreading coffee rust, and depressed world prices. Guerrilla attacks and adjustments to the land reform were largely to blame for reduced cotton production; in particular guerrilla damage last fall to more than a dozen pesticide-spraying planes, and intimidation of others, is believed to have led to major cotton losses at harvest time. Torrential rains, following closely on the heels of a severe drought, took a particularly heavy toll on basic crops such as beans and corn.

Similarly, demand for industrial output languished as domestic incomes and economic activity in neighboring countries plunged. Many firms were unable to import critically needed materials because of severe foreign exchange shortages. In addition, guerrilla bombings of economic infrastructure caused major problems. The Embassy estimated that the interruption of electric power generation alone caused more than \$60 million in industrial production losses last year.

Bleak Prospects for 1983

An economic recovery is unlikely this year because of the persistent insurgency and continued foreign exchange shortages. Consistent with their aims of

undermining the country's economy, the guerrillas have escalated their sabotage of power facilities and seriously damaged several important bridges. Meanwhile, sluggish world and regional economies will permit little if any growth in Salvadoran exports. Current forecasts by commodity analysts and the US Embassy show no significant strengthening of prices for coffee, cotton, and sugar in the near term.

Continued net private capital outflows, another poor export performance, and an IMF requirement to pay off foreign arrearages will make a real increase in imports unlikely this year. Assuming the insurgency does not escalate further and the political schisms within the present government are healed, about \$450 million in net flows of foreign assistance and/or borrowing will be needed to prevent Salvadoran real imports from falling below last year's total. Because of the close relationship between El Salvador's import and national output, any decline in real imports would almost assure another real drop in GDP.

One potentially positive development this past December was President Magana's creation of a joint government-private-sector National Economic Re-activation Committee to find ways of promoting a private-sector-led economic revival. If such efforts give birth to initiatives to expand private investment incentives and to allocate larger amounts of scarce foreign exchange and domestic bank credit to the private sector, some small progress could be made toward restoring investor confidence. Beyond this, clear and consistent policy decisions on agrarian reform would dispel uncertainty and probably boost crop land utilization and productivity. So far, we have not noted appreciable movement in any of these directions.

Either an expansion of the insurgency or increased political tensions between the extreme right and moderate factions of the government would seriously weaken the economy and greatly increase the need for foreign financial assistance. Recent mili-

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Land Reform Status

On 6 March 1980 the Salvadoran Government inaugurated a land reform program affecting roughly one-third of the country's farmland. The land reform was divided into three phases:

- *The expropriation and redistribution of land under Phase I, involving properties having more than 500 hectares, has been essentially completed. More than half of the country's sugarcane and more than one third of its cotton are grown on these lands. At yearend 1982, 328 properties had been acquired and converted into farming cooperatives. About 40 of these cooperatives have been abandoned or are operated only sporadically because of their location in guerrilla-infested areas. Compensation for Phase I estates is to be paid solely in bonds with maturities ranging from 20 to 30 years.*
- *Phase II, which calls for the expropriation of estates between 100 hectares and 500 hectares, has not been implemented. These properties contain most of the lucrative coffee-growing areas.*

Owners of Phase II expropriated farms would be compensated 25 percent in cash and 75 percent in bonds. Because government officials fear that implementation of this phase would seriously hinder the country's cash crop export earnings, it has been shelved.

- *Phase III, the land-to-tiller stage, was intended to give peasants full title to as much as 7 hectares of farmland that they either rented or tilled at the time of the reform proclamation. This phase is expected eventually to affect 178,000 hectares and to benefit up to 150,000 families. Most of the eligible holdings produce basic grains and cotton. The renter or tiller must take the initiative to seek title. Toward the end of last year, about 58,500 applications had been filed. Provisional titles had been issued to about 60 percent of the applicants and 1,146 final titles had been issued. Phase III has been a substantial budgetary burden on the government because former owners must be paid 50 percent in cash and 50 percent in bonds.*

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tary successes have given the guerrillas at least temporary territorial gains, worldwide attention, and a boost in confidence. Based on apparent guerrilla military capabilities and intentions, we believe that a worsening of security conditions—although not likely—is possible. If a significant deterioration in security should occur this year, the little remaining business confidence would evaporate, thereby causing an acceleration of capital flight and a further exodus of managerial and technical talent.

Meanwhile, rightist leader D'Aubuisson is attempting to use the recent rebellion of a key military commander to force Defense Minister Garcia to resign. Although the military would likely replace Garcia with another pragmatist, the perception of rising rightwing influence would intensify uncertainty within some elements of the business community and alarm El Salvador's peasant and working classes. Should the reforms appear threatened, middle to lower class popular sympathy for the insurgents might grow.

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